

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
UNION PACKING COMPANY)

A p p e a r a n c e s :

For Appellant: Alvin F. Howard
Attorney at Law

For Respondent: Joseph W. Kegler
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Union Packing Company against a proposed assessment of additional franchise tax in the amount of \$61,413.87 for the income year 1960.

The issue to be decided in this appeal is whether appellant realized the entire gain on the sale of its Blythe Ranch during income year 1960.

Appellant was incorporated under the laws of California in 1923 and has been engaged principally in the meat packing business. It reports on the accrual basis. In an effort to settle existing claims of the United States Government, appellant together with certain individuals against whom the claims also existed, made a written settlement proposal to the government dated July 15, 1959. This offer was accepted on behalf of the government in August 1959.

The compromise settlement agreement provided in part:

1. We, the undersigned, will pay to the United States, the sum of TWO MILLION DOLLARS (\$2,000,000.00). There will be no interest on the aforesaid sum since it is contemplated that

Appeal of Union Packing Company

the amount will, in effect, be paid in its entirety upon acceptance of the Offer. Said principal sum of \$2,000,000.00 shall be paid by application of funds now in possession of the United States, as hereinafter set forth in Section 2, by credits for property to be assigned and/or liquidated for the account of the United States, as set forth in Section 3, and by a cash payment, as set forth in Section 4.

* * *

3. It is agreed that, upon acceptance of this Offer, Union Packing Company will execute

- (1) a deed to its interest in the Blythe Ranch, including the Blythe residence;
- (2) a deed to its interest in the parking lot; and
- (3) an assignment of its stock in Los Angeles Live Stock Feed Yards, Ltd.,

to which properties reference is made in paragraph 4 hereof, and shall deposit the deeds and assignment in escrow with the District Director of Internal Revenue Service at Los Angeles (hereinafter referred to as the District Director), or his designee, who hereby is authorized to record either or both deeds and to sell the property and the stock at any time and in any manner that he deems to be in the Government's best interests. In the event that the District Director, or his designee, causes the recordation of either or both deeds, or sells the property or the stock, or both, in any manner that he chooses, credit shall be given to the Proponents by application against the balance due upon this agreement in the amount or amounts specified in paragraph 4 hereof.

4. The following credits will be made in satisfaction of Proponents' obligations hereunder:

(A) The Blythe Ranch.

(i) Union Packing Company is the owner of certain property known as the Blythe Ranch, described on Exhibit A attached hereto, which property is subject to the encumbrances shown on said exhibit. Said property has been valued by the Internal Revenue Service as having a gross forced sale value, before deduction of said encumbrances, of \$971,440.86, and a net forced sale value of \$719,056.95. The encumbrance shown on said exhibit, in the original principal amount of approximately \$6,000,000.00, in favor of Bank of America.

National Trust and Savings Association, was not taken into account by the Internal Revenue Service in determining the net forced sale value of the aforesaid property as at June 28, 1958, and Proponents, as part of this Offer, agree to cause the Bank of America National T-rust and Savings Association to release the aforesaid encumbrance.

(ii.) It is agreed that, immediately upon acceptance of this Offer, the Blythe Ranch will be placed on the market for sale at a price of \$971,440.86 cash, (excluding expenses of sale) and Proponents will use all due diligence to consummate a sale on these terms or better, and the District Director will arrange for the discharge of the tax liens on said property in the event of such a sale. Should it prove impossible to consummate a sale at such price for cash within a period of six (6) months from acceptance of this Offer, Proponents agree to use all due diligence to sell the property on the best terms possible, provided said terms are agreeable to the District Director, or his designee. Upon submission of a proposal for the sale of such property, or a portion thereof, which proposal is satisfactory to the District Director, or his designee, he will arrange for the discharge of the tax liens on such property, or portion thereof, under arrangements that will assure the application of the proceeds of the sale, less amounts necessary for the discharge of prior encumbrances and less reasonable selling expenses, on the aforesaid principal sum of \$2,000,000.00. Subject to the provisions of paragraph 3 hereof, if the Proponents are unable to sell this property within a period of thirty-six (36) months from the date of acceptance of this Offer, the District Director, or his designee, may, at his option, cause recordation of the deed to the property, and if such is accomplished, proceed to sell the property and apply the proceeds therefrom, less amounts approved by the District Director, or his designee, as expenses necessary for the discharge of prior encumbrances and reasonable selling expenses, on the aforesaid principal obligation of \$2,000,000.00.

(iii) As previously indicated, the United States has valued the Blythe Ranch as having a net forced sale value of \$719,056.95, and believes such value to be fair and reasonable. Accordingly, it is agreed that, should the net amount realized from the sale of such property be less than \$719,056.95, Proponents shall nonetheless be credited with having paid the sum of \$719,056.95 toward the principal obligation of \$2,000,000.00.

Appeal of Union Packing Company

(iv) Until the Blythe Ranch is sold by Proponents, as provided herein, or until the District Director, or his designee, records the deed thereto, as provided in paragraph 3, Proponents shall pay all real property taxes, water and other utility charges, principal and interest payments falling due on trust deeds or mortgages, and all other expenses necessary for the preservation, maintenance and proper upkeep of said property, and all income from said property during said period shall be retained by Proponents.

* * *

8. It is further agreed that the tax liens securing the deficiencies in taxes determined in the Tax Court proceedings, referred to above, shall continue in full force and effect with reference to the aforementioned Blythe Ranch, stock in Los Angeles Live Stock Feed Yards, Ltd., the parking lot and the Blythe Residence, until such properties are liquidated in accordance herewith.

* * *

Appellant gave the United States Government a deed to the Blythe Ranch and placed it up for sale in accordance with section 4(A) (ii) of the agreement. The government did not record the deed. A sale was negotiated, and by means of a grant deed dated September 28, 1960, appellant transferred title to Union Feed Yards, Inc. The total consideration paid by the purchaser amounted to \$1, 208,503.00, with \$719,056.95 of this amount going through escrow to the Internal Revenue Service. During the period between August 1959 and October 14, 1960, the date the escrow was closed, appellant operated the ranch and carried out its duties pursuant to section 4(A)(iv) of the agreement.

Respondent contends that the entire gain from the sale of the Blythe Ranch was realized in 1960 when the ranch was sold to Union Feed Yards, Inc.

Appellant, on the other hand, contends that it received an immediate, unconditional credit in the amount of \$719,056.95 with respect to the Blythe Ranch from the United States Government at the time the agreement was executed in August 1959 and, accordingly, that a portion of the gain was realized in that year. The balance of the gain, according to appellant, was realized in 1961. Appellant states that not

Appeal of Union Packing Company

until 1961 could it be determined how much of the gain from the sale of the Blythe Ranch would belong to it since this was dependent upon the amount of proceeds realized from the remaining properties specified in the agreement.

A sale of realty is complete and the gain is includible in income when the buyer has assumed the burdens and benefits of ownership and no substantial contingencies remain to be satisfied. (Commissioner v. Union Pac. R.R. Co., 86 F.2d 637; Frost Lumber Industries, Inc. v. Commissioner, 128 F.2d 693; Harris Trust & Sav. Bank, 24 B.T.A. 498; Standard Lumber Co., 28 B.T.A. 352.) There was no sale or gain in 1959 when appellant executed a grant deed to the ranch pursuant to the agreement and deposited it with the District Director of Internal Revenue. It is a well established principle that the incidence of taxation depends upon the substance of a transaction rather than its form. (Commissioner v. Court Holding Co., 324 U.S. 331 [89 L. Ed. 981]; Griffiths v. Helvering, 308 U.S. 355 [84 L. Ed. 319].) Although the deed executed along with the agreement in 1959 purported to convey legal title to the United States Government, the evidence indicates that no sale was intended by the parties and beneficial ownership of the ranch remained in appellant until it was conveyed to Union Feed Yards, Inc. in 1960. (James B. Lansley, 44 B.T.A. 1105; Marsan Realty Corp., T.C. Memo., Dkt. Nos. 92671-92673, October 29, 1963.)

Consistent with this conclusion are the facts that: (1) the 1959 agreement did not give an immediate credit but instead provided that a \$719,056.95 credit would be given if the District Director of Internal Revenue recorded the deed to the Blythe Ranch or sold the property; (2) the government never recorded the deed; (3) appellant retained possession and continued to operate the ranch; (4) appellant continued to make payments of principal and interest on trust deeds on the property; (5) it was agreed that appellant would attempt to sell the property; (6) the government was to retain its liens until the property was sold; (7) appellant sold the property in 1960 in its own name; and (8) the government returned the unrecorded deed to appellant after receiving payment. Since it is apparent that the deed to the government did not affect the substantive ownership but was intended as a security measure, that deed will be disregarded for the purposes of determining appellant's tax liability.

Under these circumstances, we believe respondent correctly determined that the entire gain from the sale of the Blythe Ranch was realized in 1960, when the ranch was sold to Union Feed Yards, Inc. No part of the gain could properly be deferred until 1961; all of it accrued to appellant's

Appeal of Union Packing Company. 1967

benefit in 1960. Immediately upon the sale in 1960, the entire gain was committed to appellant's own purposes, in that it was to be used to satisfy its obligations under the settlement agreement and any excess was to be retained by appellant.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Union Packing Company against a proposed assessment of additional franchise tax in the amount of \$61,413.87 for the income year 1960, be and the same is hereby sustained.

Done at Sacramento , California, this 24th day of April , 1967, by the State Board of Equalization.

Frank R. Leake, Chairman
John W. Lynch, Member
Richard J. [unclear], Member
Alton [unclear], Member
[unclear], Member

ATTEST: [Signature], Secretary